ARIES

Agriculture, Rural Investment and Enterprise Strengthening Program in Afghanistan

MISFA-MFI Program Brief No. 3

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The Financial Integration, Economic Leveraging, Broad-Based Dissemination Leader with Associates (FIELD-Support LWA)

The ARIES Program is a sub-award under the FIELD-Support Leader with Associates (LWA) cooperative agreement — a single, 5-year award created to both advance the state-of-the-practice in microenterprise development and microfinance as well as assist USAID missions and other operating units to design and implement innovative, integrated, market-based approaches to sustainable economic growth with poverty reduction.

Through sector assessments, program design, technical evaluations, and implementation of multi-year projects, FIELD-Support allows USAID Missions and other operating units to pursue their strategic objectives to:

- Strengthen livelihoods and food security for marginalized groups, youth, women and other vulnerable populations such as people affected by HIV/AIDS and natural disasters;
- Foster enterprise development, job creation and broad-based economic recovery in conflict and post-conflict situations as well as other fragile environments;
- Extend the reach of microfinance and develop more inclusive financial systems;
- Upgrade and improve the competitiveness of value chains in which microenterprises participate; and
- Facilitate institutional strengthening and policy reform for broad-based economic growth.

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MISFA MFI Program Brief

The following is one in a series of briefs highlighting the experiences and lessons learned under the USAID Agriculture, Rural Investment and Enterprise Strengthening (ARIES) Program. A $100 million, three-year initiative, ARIES aims to create a strong private sector foundation for a sustainable, market-driven rural finance system in Afghanistan. ARIES targets USAID's Alternative Development Program (ADP) regions in the east, south and north of Afghanistan, as well as Herat Province in the west.

ARIES is managed by the Academy for Educational Development (AED) in partnership with ACDI/VOCA, the World Council of Credit Unions (WOCCU), the Microfinance Investment Support Facility for Afghanistan (MISFA), FINCA and ShoreBank International (SBI). Each partner focuses upon a different component of the financial landscape, from household micro-loans of less than $200 to loans of over $1 million to larger scale Small and Medium Enterprises (SMEs). In addition, WOCCU's affiliate in Afghanistan also offers savings services to members.

Activity Profile

Goal: The objective of ARIES' support to MISFA's microfinance wholesale lending arm has been to increase the program's overall coverage by providing loan capital to selected MFIs operating in the target regions while also contributing to MISFA's institutional development. This "MISFA/MF" component complements ARIES' direct microfinance support to WOCCU and FINCA.

Specific targets established for the MISFA/MF effort were to disburse a cumulative total of 110,500 loans worth US $32.5 million in USAID's ADP target regions over the life of the project.

Implementing Partners: In addition to direct support for MISFA, this project component indirectly supports six MFIs to which ARIES funds are on-lent: the Afghanistan Rural Micro-credit Program (ARMP), BRAC, Microfinance Afghanistan, Oxus, the Microfinance Agency for Development and Rehabilitation of Afghan Communities (MADRAC), the Children's Fund Afghanistan (CFA), and SUNDUQ.

Funding Level: US $9 million.

Role within ARIES: This component of the ARIES project supports small-scale loan products, as the MISFA/MF partners offer microfinance loans ranging from under US $200 to $10,000. ARIES' other microfinance partners provide loans of US $100 to $5,000, and its SME financing initiatives, through MISFA's SME Department and ACDI/VOCA's ARFC, offer loans from US $5,000 to over $2 million.

Overview

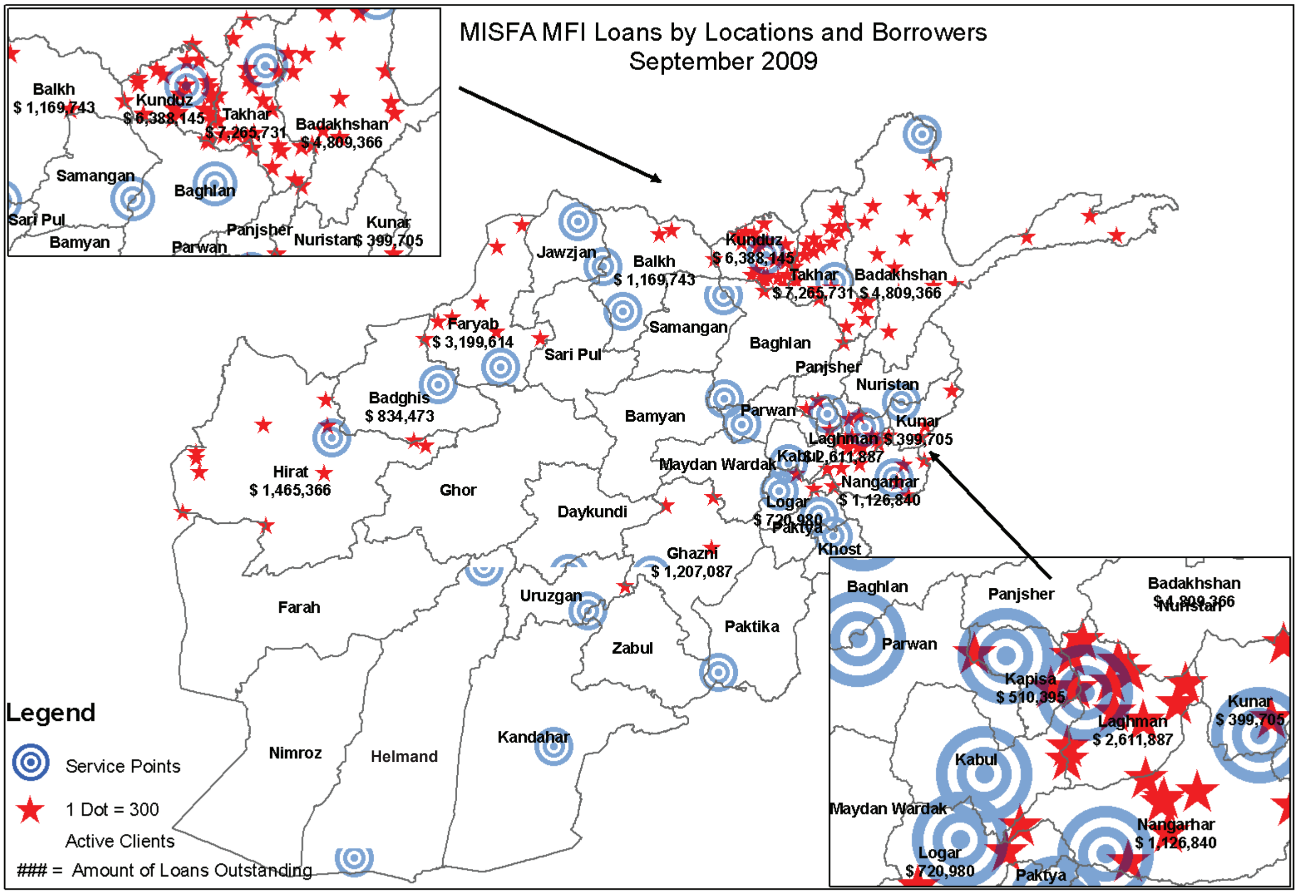
MISFA was established in 2003 at the request of the Government of Afghanistan to coordinate donor funding and technical assistance to the microfinance sector. MIFSA has evolved from a project into a self-sustaining institution functioning as an independent apex funding organization. Since 2006, it has been registered as an LLC (Limited Liability Company) with the Ministry of Finance as its sole shareholder. MISFA's vision is to "have a positive economic and social impact by facilitating the development of the Afghan financial sector, increasing access to the un-banked, especially women, and rural and poorer households. As a double-bottom line institution, MISFA aims to promote a sustainable sector that operates without subsidies. In pursuit of that goal, MISFA currently coordinates with 15 MFI partners in 27 of Afghanistan's 34 provinces.

Operations

At the project's outset, AED and MISFA established parameters for Program support, which included: areas of operations, target market and institutional capacity. From this, partners with the greatest potential to advance USAID's objectives were selected. BRAC, for example, has a particular focus on attracting and retaining female clients; and over 30% of ARMP's borrowers are recently repatriated Afghans. Each of the six selected MISFA/MF partners has significantly grown operations since the program's inception and, as of September 2009, they had disbursed US $31.7 million, representing 97.5% of the $32.5 million target. As illustrated by Table 1, the partners operate 65 financial service outlets across 13 provinces within the ADP regions, as well as in Herat province.

Table 1. MISFA/MF Coverage

	MISFA/MF Partners					
ADP Region	ARMP	BRAC MF	CFA	MADRAC	Oxus	SUNDUQ
North Balkh, Badakhshan, Takhar, Kunduz, Faryab	X	X	X		X	
East Nangarhar, Ghazni, Kapisa, Laghman, Logar, Kunar		X		X		X
West Herat, Badghis		X		X		



Wholesale financing instrument

As a wholesale apex institution, MISFA on-lends funds to MFI partners at an interest rate of 5% per annum. While this is not necessarily a commercial interest rate as it does not fully cover the country risk of lending in Afghanistan, it reflects progress toward commercialization of the microfinance sector, which previously relied on grants and 0% interest loans. At this interest rate, MISFA is able to cover the full costs of its lending operations.

Performance

As of September 2009, the MISFA/MF Partners had disbursed a total of 93,800 loans to nearly 35,000 clients through ARIES support. Approximately 54% of the clients supported were women and the total value of loans stood at US $31.7 million. The loan volume demonstrates strong demand for microfinance across a wide range of ADP regions. Loans are primarily used to expand the trade and services sectors (approximately 57%), followed by household manufacturing, agriculture and income-smoothing purposes.

While MISFA's portfolio at risk remains extremely low with just 0.37% of its portfolio past-due beyond 30 days, PAR_{30}, six of MISFA's partner MFIs PAR_{30} exceeds 10%, with MISFA's overall exposure representing $38.5 million or 41.5% of its total portfolio outstanding as of January 2009.[1]

To ensure its ongoing sustainability, and the progress toward commercialization of the microfinance sector, MISFA is prepared to make some tough decisions and discontinue lending to those MFIs that do not demonstrate adequate progress toward sound portfolio and operations management in the future.

Achievements

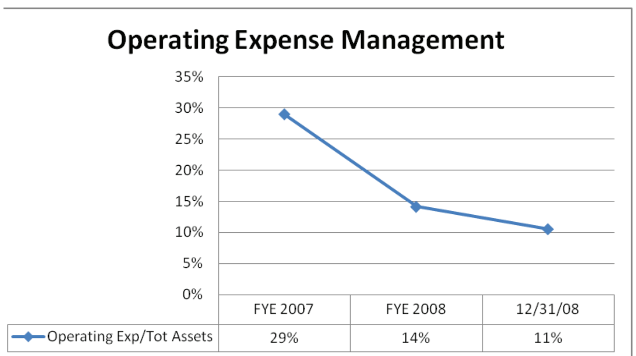
- Created or supported over 82,300 jobs in rural Afghanistan.
- Supported MFIs that issued 93,800 loans worth US $31.7 million in USAID ADP areas, as well an additional US $90 million in other parts of Afghanistan.

[1] Portfolio at Risk (PAR) is calculated by dividing the outstanding balance of all loans with arrears over 30 days, plus all refinanced (restructured) loans by the outstanding gross portfolio as of a certain date. Since the ratio is often used to measure loans affected by arrears of more than 60, 90, 120 and 180 days, the number of days must be clearly stated (for example PAR_{30}). Generally speaking, any PAR_{30} exceeding 10% should be cause for concern, because unlike commercial loans, most microcredits are not backed by bankable collateral.

- Supported nearly 19,000 women through direct lending.
- Encouraged progress toward commercialization of the microfinance sector by providing training and institution building support to MFIs, as well as the application of best-practice standards.
- Improved its own operational efficiency by reducing operating expenses from 29% of total assets at FYE07 to just 11% of total assets as of YE08 (see graph below).

Challenges, Adjustments and Lessons Learned

For all of the ARIES partners project goals have remained the same while the strategy for achieving them has evolved. MISFA and its partner MFIs have faced significant hurdles to providing rural Afghans with access to formal microfinance services. The following points illustrate challenges, how the project has adjusted in response, and the lessons learned for others working in similar contexts.



Challenge: *Deteriorating security conditions limit movement and threaten capacity to operate. Field operations in Afghanistan have been affected by increasingly deteriorating security and increasingly limited access to rural areas since ARIES was established. This has affected the transfer of funds between Kabul and branch offices, loan disbursement and collection, and the areas where outreach can be conducted. It has also constrained organizational development and operational oversight.*

Adjustment: *MISFA has advocated alternative cash management strategies to reduce the risks of cash-handling by staff and clients; to transfer cash some of the MFI partners currently use the informal but highly-developed hawala system — an informal network of money brokers operating without promissory instruments. In addition, an M-Commerce initiative is under development by ARIES in partnership with Afghanistan's largest mobile phone provider ROSHAN, and three MISFA/MFIs. The pilot project aims to establish a safer, less cash-dependent means of transferring money between MFI branches as well as between MFIs and their clients. To reach rural female clients (most of whom run home-based businesses), some MFIs have hired female loan officers.*

Lessons learned: *Despite the ongoing conflict, demand for microfinance services is incredibly high. Meeting this demand responsibly, particularly in light of the fluidity of the conflict, requires innovative and imaginative solutions to capable operation in the absence of frequent on-sight management reviews, and reduction of the risks inherent in transferring large amounts of money around the country. These solutions lie in many places, including both traditional systems and new technology. Programs should explore and weigh the benefits of both as the sector continues to grow. While some of these solutions hold significant promise for increasing access in the future, they generally result in higher implementation costs, at least in the short-term.*

Challenge: *MFI human resource capacity remains limited.*

Adjustment: *MISFA has facilitated multiple trainings for MFI loan officers and other staff in attempt to strengthen MFI human resource capacity. In addition, MISFA is in the process of standardizing the monitoring and reporting modalities of all of its partners, including those supported by ARIES. This will allow the lender to better assess the performance of both individual institutions and the broader sector and design appropriate responses to address the gaps.*

Lessons learned: *More than two decades of conflict has disrupted educational systems and continuity; basic literacy and numeracy levels across the country are low. This affects MFI staff capacity and institutional development. Despite MISFA's and the MFI's attempts to strengthen microfinance staff, many have had to hire from outside the country for senior management positions. This challenge is exacerbated by a highly-competitive local market for skilled labor as NGOs and donor agencies continually look for the most highly-experienced staff.*

Challenge: *Pressures to offer Sharia-compliant (congruent*

with Qur'anic law) products. Traditional microfinance models can be subject to criticism in conservative rural areas of Afghanistan as their reliance on interest to cover costs is often considered contrary to Qur'anic law.

Adjustment: *MISFA has engaged two Sharia scholars to review the products offered by its MFI partners, who recommended ways of standardizing and offering Sharia-compliant loans. Though it is expected that many MFIs will continue to offer both conventional and Sharia-compliant options, MISFA/MF partners now have improved guidance on how to meet the demands and cultural expectations of Afghanistan's market.*

Lessons learned: *Due to the increased number of steps and the staff time necessary to offer them, Sharia-compliant loans are often more costly for MFIs to provide and, therefore, for clients to access. Once the MFI explains the costs involved in Sharia-compliant loans, many clients choose the traditional interest bearing loan. Nonetheless, many of the MFIs have found that it is culturally important to offer both options and to leave the final decision up to the client. While the cost of offering Sharia-compliant loans may be higher than that for conventional products, the longer term cost of not offering Sharia-compliant options could be far greater.*

Challenge: *The push for growth and expanded outreach has resulted in poor portfolio quality for some of MISFA's MFI partners.*

Adjustment: *MISFA is committed to supporting sound financial institutions and has created performance 'report cards' to hold its partners accountable for improving their results. Following the initial scoring, MFIs have designed and are now implementing restructuring plans which are closely monitored by MISFA. The ability of troubled MFIs to improve their balance sheets will determine whether they will continue to be eligible for MISFA support or will have clients transferred out of their institutions and into healthier MFI partners.*

Lessons learned: *While it can be politically important to expand lending to the poor in a conflict-affected country like Afghanistan, rapid growth often masks portfolio quality problems. When an MFI focuses on expanded outreach without ensuring that adequate internal controls are in place, small issues can rapidly become large problems. If an MFI becomes known to be weak on collecting problem loans, even its sound portfolio can have difficulties. Therefore, early warning systems and rapid responses to problems are required to mitigate the negative impact of such risks.*

Moving Forward

MISFA's core objectives include improved progress toward commercialization as well as "Afghanization" of the sector, which means the transfer of ownership and control over the industry to Afghan nationals and the establishment of a range of sustainable providers of microfinance within the country. In the immediate to medium-term, the following are MISFA's priorities:

- To continue to build local institutional capacity for MF financing by supporting training and institutional capacity building efforts, as well as requiring that MFIs apply international best practice standards to their operations.
- To consolidate the microfinance sector by facilitating the transition of sound microfinance clients from MFIs that have not been able to achieve the minimum requirements to continue to have access to MISFA's funding and technical assistance support to those that do meet the requirements.
- To be an innovator in expanding access to finance to un-served markets. In support of its development objectives, MISFA continues to broaden its mandate to include other sectors not served by the private financial sector. In addition to its ARIES-supported window for SME finance, it is also in the process of exploring a window for agricultural finance, for which it also plans to support through technical assistance and training as well as wholesale lending.
- To continue to play a role in coordinating donor and government interventions in the microfinance sector. In its position as the microfinance apex institution in Afghanistan, MISFA continues to be the initial point of contact for any potential interventions in the microfinance sector, which facilitates a balanced and managed approach to developing the sector, as well as reduces the chance of interventions that can undermine natural market mecha-

nisms, such as the use of inappropriate subsidies. In addition, MISFA continues to the play role of supervising the sector, as Afghanistan still lacks a regulatory framework for microfinance.

Over the longer term, as MISFA is a wholesale finance institution with commercial and social objectives, it will continue to support MFI partners as they broaden their range of products offered, while improving their long-term sustainability.

The Microfinance Investment Support Facility for Afghanistan (MISFA) is a wholesale lending institution that channels funds from bilateral donors to microfinance institutions that offer competitive, transparent and effective services. MISFA was established as a vehicle through which the Afghan Government and international donors could channel technical assistance and funding to build Afghanistan's microfinance and small and medium enterprises (SME) lending sectors.

www.misfa.org.af

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